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Statement of
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before the

Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security
Committee on Homeland Security and Governmental Affairs

United States Senate

Thank you for the opportunity to testify before the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security regarding NASA's use of cost-plus award fee contracts to incentivize excellent contractor performance.

NASA is unlike most civilian agencies. NASA programs and projects, whether going to the Moon, looking back at Earth, or making aircraft safer, have one thing in common: they are high risk. That is really the core of NASA's mission: doing things that have never been done before. There are many challenges involved in high-risk programs. They require more than special hardware or design. These programs require high-risk contracting. Every new concept for a space craft, a satellite, or rover comes to life through high-risk contracting. Actually, these programs derive from high-risk acquisitions, because more than contracting is involved, including an entire team of project managers and contract specialists. High-risk missions are always a challenge and award fee contracts, when used effectively, can assist in meeting the challenge of these high risk contracts.

NASA has been proactive in implementing award fee contracting policies consistent with the Office of Management Budget (OMB) Office of Federal Procurement Policy (OFPP) memorandum dated December 4, 2007, entitled, "Appropriate Use of Incentive Contracts," and the requirements set forth in the FY 2009 National Defense Authorization Act (NDAA), Section 867, entitled, "Linking of Award and Incentive Fees to Acquisition Outcomes," as outlined below.

NASA awarded 62 percent of all contracts as award fee contracts in FY 2008 (see NASA Annual Procurement Report for FY 2008). These award fee contracts are not considered "bonuses." Award fee contracts are used by the Agency for those efforts where key elements of performance cannot be objectively measured. In this situation, most elements of contractor performance can only be evaluated using subjective criteria. Under an award fee contract, an available award fee pool is negotiated and included in the contract. Criteria for contract performance are included in the contract via an award fee incentive plan, and the contractor is then judged on how well it performs in relation to those criteria in order to earn any award fee.

The actual award fee earned by the contractor is determined by the Government's assessment of the contractor's performance in the areas of cost, schedule, and technical performance that is delineated in the award fee criteria. A Performance Evaluation Board is appointed with the primary responsibility of conducting periodic evaluations of the contractor’s performance, as well as submitting an evaluation report to the Fee Determining Official (FDO) that delineates the board’s findings and recommended changes, if any, to the award fee evaluation plan. The FDO is responsible for determining the award fee earned and payable for each evaluation period as addressed in the contract. In addition, one or more performance monitors may be assigned with responsibility for monitoring and evaluating contractor performance. The contractor can earn any amount of award fee, from all of the award fee pool to none of it. Under NASA procurement policy, a contractor will not be paid any award fee or base fee for less than satisfactory overall performance.

Determining Appropriate Contract Type

NASA’s approach to contract type selection is to match the unique circumstances of the procurement with the appropriate contract type. The majority of NASA’s procurements are for complicated Research and Development (R&D) efforts that involve complex requirements where the likelihood of change makes it difficult to estimate performance costs in advance. In addition, these R&D efforts involve state of the art technologies that often have a high degree of technical risk associated with them.

In this R&D procurement environment, contractors are not able to adequately forecast and propose a reasonable fixed price. Given complex requirements, significant technical risk, and cost uncertainty; a cost-reimbursement type contract is appropriate. Use of fixed price type contracts under these circumstances would also invariably result in contractors proposing significantly higher prices to compensate for the high risk. A key benefit in using cost-reimbursement contracts is that they offer significantly more flexibility for making changes or adjustments to contract requirements that become more refined as a result of progress on development work, in particular under a contracted R&D activity. This flexibility mitigates the likelihood of increased contractor claims, and the ongoing cost of their resolution, which could be expected with the use of fixed price contract vehicles for this kind of work.

In order to mitigate the Government’s risk under cost reimbursement type contracts, NASA utilizes incentive arrangements; such as award fee incentives, performance fee incentives, cost incentives, and schedule incentives with our cost contracts. Consistent with the OMB/OFPP memorandum on the use of incentive contracts, NASA’s policies require preparation of a cost/risk benefit analysis showing that the additional costs of administering an award fee contract are more than offset by the expected benefits as part of the approval process to use an award fee contract.

Linking Incentive Fees to Acquisition Outcomes

In compliance with the OMB/OFPP memorandum on the use of incentive contracts as well as section 867 of the 2009 NDAA, NASA’s procurement policies require that award fee incentive arrangements contain clear, unambiguous, and measurable evaluation criteria that are linked to the cost, schedule, and technical performance requirements of the contract. The linking of award fee evaluation criterion to acquisition outcomes ensures that the contractor has a distinct incentive to control costs and produce a high quality item in a timely fashion.

Establish Standards for Contractors to Earn Award Fee

Both the OMB/OFPP memorandum on the use of incentive contracts as well as section 867 of the 2009 NDAA provided guidance relative to the establishment of standards for determining the percentage of award fee, if any, which contractors should be paid for performance that is judged to be excellent, good, or satisfactory. NASA's procurement policy has expressly established a standard award fee rating system that is required to be used on all NASA award fee contracts. NASA utilizes a five tier adjectival award fee rating system (i.e. excellent, very good, good, satisfactory, and unsatisfactory) with an associated description of what these adjectival ratings mean and how much award fee the contractor can earn for a given adjectival rating. The adjectival rating descriptions were crafted so as to require that the contractor meet the overall cost, schedule, and technical performance requirements of the contract as defined and measured against the criteria in the contract's award fee plan. These adjectival rating descriptions ensure that the contractor must exceed all the factors of the award fee plan criteria to earn the maximum available award fee. The percentages relative to the amount of award fee available to be earned associated with these adjectival ratings clearly reflect that no award fee can be earned for unsatisfactory performance while a larger percentage of award fee can be earned for excellent performance. NASA award fee policy is consistent with the OMB/OFPP memorandum on the use of incentive contracts as well as section 867 of the 2009 NDAA in that no award fee will be given to a contractor when performance is judged to be unsatisfactory.

Establish Guidance relative to Roll Over of Unearned Award Fee

The process of transferring unearned award fee, which the contractor had an opportunity to earn, from one evaluation period to a subsequent evaluation period, thus allowing the contractor an additional opportunity to earn that unearned award fee is termed a "roll over of unearned award fee". The OMB/OFPP memorandum on the use of incentive contracts stated that the roll over of unearned award fee amounts "is not the preferred method for incentivizing the contractor to perform above satisfactorily and should be permitted on a limited basis and require prior approval of the appropriate agency official."

Contractors must be held accountable for substandard performance. The roll over of unearned award fee allows the contractor the opportunity to earn award fee that has already been lost due to poor performance, thereby effectively removing the incentive to improve performance. NASA's procurement policy prohibits the use of the roll over of unearned award fee because this practice diminishes the effectiveness of the award fee rating given for each specific evaluation period.

Collecting/Analyzing Award Fee Data

NASA has implemented tracking of award fee as part of the Baseline Performance Review (BPR) process. The BPR is an independent, monthly assessment of selected NASA programs/projects that informs senior leadership of the contractor's performance under these efforts as measured against the approved baseline for these acquisitions. As part of this review, award fee ratings on selected programs/projects are reported and discussed relative to the contractor's current performance level.

Measuring Effectiveness of Award Fee Contracts

Section 867 of the FY 2009 NDAA requires that agencies "include performance measures to evaluate the effectiveness of award and incentive fees as a tool for improving contractor performance and achieving desired program outcomes." NASA understands that a Federal Acquisition Regulation (FAR) rule change is in process to implement this requirement. Furthermore, the GAO report, GAO-09-630, entitled "Guidance on Award Fees Has Led to Better Practices but Is Not Consistently Applied," recommended the establishment of an interagency working group to determine how best to evaluate the effectiveness of award fees as a tool for improving contractor performance and achieving desired outcomes as well as developing methods for sharing information on successful strategies. NASA concurs with this recommendation and is actively participating on this interagency working group and looking forward to implementing the eventual recommendations from this group. The working group membership includes Federal agencies such as NASA, the Department of Defense, Department of Homeland Security, Office of Federal Procurement Policy, Department of Health and Human Services, Department of Energy, and the Government Accountability Office.

Again, thank you for the opportunity to appear before this Subcommittee today. I would be pleased to respond to any questions that you may have.